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IN THE

# Supreme Court of the United States,

OCTOBER TERM, 1931.

No. 179.

HERBERT S. DANIEL, Trustee of Peters Trust Company, Bankrupt,

*Petitioner,*

*against*

GUARANTY TRUST COMPANY OF NEW YORK,

*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

## BRIEF OF RESPONDENT.

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CHARLES POLETTI,
Counsel for Respondent.

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GUARANTY TRUST COMPANY OF NEW YORK,
Respondent,

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

## BRIEF OF RESPONDENT.

### Introductory.

This case arises out of the order of a referee in bankruptcy (R. 19), directing the respondent, Guaranty Trust Company, forthwith to pay to the petitioner, trustee in bankruptcy, the sum of $23,724.60. The District Court, on petition for review, affirmed this order (R. 28). The Circuit Court of Appeals reversed the District Court (R. 42); and this Court, on October 19, 1931, granted a writ of certiorari.

No opinion was rendered by the referee or by the District Court. The opinion of the Circuit Court of Appeals is re-

ported in 49 F. (2d) 866, and appears at R. 37-42. Jurisdiction is invoked under § 240a of the Judicial Code (U. S. Code, T. 28, § 347).

## Statement of the Case.

On November 25, 1929, Peters Trust Company of Omaha, Nebraska, was declared insolvent and was placed in liquidation by a consent decree in the state court. On November 27 an involuntary petition in bankruptcy was filed in the Federal Court, and on December 10 (apparently prior to any action on the involuntary petition) Peters Trust Company filed a voluntary petition in bankruptcy and was adjudicated bankrupt. On the same day Herbert S. Daniel, the petitioner, was appointed receiver; and on March 17, 1930, he became trustee.

Immediately prior to the state insolvency proceedings, Peters Trust Company had ordered four consignments of bonds from the Guaranty Company of New York. These bonds were shipped to Peters Trust Company between November 20 and 23, the last two consignments not being delivered until after the state liquidating agent had assumed control (R. 5). The purchase price due on the bonds was $23,055.82 (R. 5).

On November 27, 1929, the Guaranty Company assigned its claim to the bonds to the Guaranty Trust Company, a banking corporation organized under the laws of New York, located in New York City, and having no place of business or agent in the State of Nebraska. The Guaranty Trust Company at that time had two accounts of the Peters Trust Company. The first was an open checking account, in which Peters Trust Company on November 25 had a credit balance of $31,046.53. The second was a demand loan account for money advanced to Peters Trust Company, in which on November 25th there was a debit balance of $156,700.

Pursuant to a collateral pledge agreement (R. 9) and in the exercise of its common-law right to a banker's lien, the Guaranty Trust Company on November 25, 1929, applied the credit balance in the checking account against the debit balance in the demand loan account (R. 18, 41). Its right to do this is not disputed by the petitioner. Subsequently, after taking over the claim of the Guaranty Company for the bonds shipped, the Guaranty Trust Company debited the demand loan account with the price of those bonds, $23,055.82 (R. 18-19).

At this point it may be well to explain in some detail the nature of this demand loan account, a statement of which appears at R. 18. At various times prior to November 25, 1929, Peters Trust Company had made a number of farm loans, secured by mortgages, which it intended to sell to Prudential Insurance Company, and had deposited with the Guaranty Trust Company the notes and mortgages representing those loans. The Guaranty Trust Company, against the deposit of those notes and mortgages as collateral, had advanced the full amount to Peters Trust Company, the total of these advances amounting on November 25th to the sum of $156,700., already mentioned.

As the loans were thereafter approved and accepted by Prudential Insurance Company, the amount of each loan, with accrued interest, was paid to the Guaranty Trust Company and credited to Peters Trust Company in the demand loan account—in other words, the account was gradually reduced by successive applications of portions of the collateral (the deposited mortgages) against the loan. The successive steps in this process are shown by the statement appearing at R. 18-19, which we have paraphrased in the statement appearing as an Appendix to this brief (*infra*, p. 46).

These successive applications of collateral were for the most part made after the adjudication in bankruptcy. Their propriety is not disputed. The result was that eventually the collections on collateral, coupled with the application of

the credit balance in the checking account, sufficed to wipe out the indebtedness of Peters Trust Company, leaving an admitted balance of $7,783.56 due to its trustee in bankruptcy. Of this, $7,500. was paid to the trustee on April 14, 1930 (R. 12), and the balance, $283.56, was paid after the decision of the Circuit Court of Appeals.

On April 2, 1930, the Guaranty Trust Company filed in the bankruptcy court a petition for reclamation of the bonds shipped to Peters Trust Company just prior to its insolvency and at that time in the possession of the trustee. The grounds of this petition (R. 1) were, in substance, that the purchase price was to have been paid in cash immediately upon delivery, that the bonds had been fraudulently ordered at a time when Peters Trust Company was insolvent and was known to be so by its officers, that Peters Trust Company never intended to pay for them, and that title therefore never passed.

It might, perhaps, have been argued that the filing of this petition for reclamation was inconsistent with the action previously taken in debiting the purchase price of the bonds against the demand loan account—a point which the trustee promptly raised in paragraph IX of his answer (R. 7). But it is unnecessary in this case to consider how far that earlier debiting constituted an election of remedies which might bar the subsequent petition for reclamation, as the final decision turned upon an altogether different point.

The trustee's answer in the reclamation proceedings denied the allegations of fraud in the petition, alleged that the sale of the bonds had been on credit, and asserted that title had passed to the bankrupt. In paragraph 7 (R. 6) he alleged that a part of the bonds had been purchased to fill orders of particular customers of Peters Trust Company, who were entitled to receive them on completing their payments of the purchase price. By an amendment (R. 9) he added the separate defense already mentioned, based upon the doctrine of election of remedies, as follows:

"IX. The trustee further alleges that with full knowledge of all the facts alleged in the applicant's petition, the applicant ratified and confirmed the sale of the said securities by attempting to impress a lien on the funds belonging to the bankrupt estate on deposit with the applicant, and is estopped to now reclaim said securities from the undersigned trustee."

It is to be noted that thus far the answer of the trustee was confined to raising issues or defenses germane to the issues presented by the petition; and had this been all, no question would now arise. But by paragraph 8 of his answer (R. 6) the trustee went further and attempted to interject into the proceedings an entirely new issue, in no way related to the question of title to the bonds which respondent was seeking to reclaim, and attempted to set up, in summary proceedings before the referee, an affirmative counterclaim to the entire balance of the collateral, or the proceeds from the collateral, held by the Guaranty Trust Company, in the demand loan account in New York. This paragraph, which is the crux of the present case, is as follows:

"8. Your trustee further alleges, that the Guaranty Trust Company of New York, the petitioner and applicant herein, has in its possession, on deposit, approximately the sum of $31,224.60 which belongs to the bankrupt estate, and which was accumulated by the Receiver and Trustee of said bankrupt estate since the date it was adjudicated bankrupt. The trustee has made due demand upon the petitioners for delivery of the said money, but the Guaranty Trust Company of New York has refused to deliver the said funds or any part thereof, and should be required to account for all funds collected by it on behalf of the receiver or trustee of Peters Trust Company, Bankrupt, or the bankrupt estate, and be directed to deliver the same forthwith to Herbert S. Daniel, Trustee."

The prayer of the trustee's answer was that notice should be given to the individual purchasers of the bonds named in paragraph 7, that they be directed to present their claims to

the bonds, that the petition of respondent to reclaim the bonds be denied, and:

> "The trustee further prays for an order directing the Guaranty Trust Company of New York to account to him for all funds collected or now held by it belonging to the bankrupt estate, and be ordered to deliver the same [forthwith] to your trustee, and for such other relief as to the Court may seem just and equitable" (R. 7).

On April 25, 1930, the petition for reclamation came on for hearing before the referee. At this hearing counsel for the Guaranty Trust Company moved to strike from the trustee's answer paragraph 7 (relating to the claims of individual customers) and paragraph 8 (relating to the funds held by the Guaranty Trust Company in New York), on the ground that they raised separate and distinct issues, unrelated to the question raised in the reclamation petition, and that the referee had no jurisdiction to entertain them. This motion was overruled by the referee (R. 8-9).

Thereupon counsel for the Guaranty Trust Company immediately filed a dismissal of their reclamation proceeding, and withdrew from the hearing, saying (R. 9):

> "We will file a dismissal of this reclamation proceeding. In other words, from the very first our position has been that *it has been immaterial whether we keep the money in New York under the collateral pledge agreement,* or whether we get the bonds. Now if Mr. Daniel, the trustee, is allowed to come in here and in his answer bring up these different issues, and if these other people are allowed to come in this lawsuit, as far as we are concerned, why we will dismiss the action. Now of course there isn't any counterclaim, this isn't the same as a counterclaim because we are merely asking for the custody of the bonds. Mr. Daniel has no right to come in when we ask for the custody of the bonds, and bring up a new issue."

The referee allowed this dismissal, only so far as the original petition for reclamation was concerned (R. 10, 21), but

proceeded to adjudicate the questions raised by the trustee's answer, and proceeded to make findings as to the rights of the customers of Peters Trust Company to the bonds ordered from New York. Upon the basis of these findings he ordered (R. 21-22) that these customers should receive the various allotments of bonds "upon the payment by said respective persons to said Trustee of any sums which may be due from said respective persons to said bankrupt estate."

The propriety of this adjudication is not now disputed and is not involved in this case. But the referee did not stop there, or content himself with adjudicating the question of title to the bonds in the custody of the trustee, which was the sole question raised by the reclamation petition. Instead he proceeded, in the absence of counsel for the Guaranty Trust Company, and against their protest, to hear and determine the claim of the trustee to recover the funds held by the Guaranty Trust Company in New York,—i.e., the proceeds of the collateral in the demand loan account, to which Guaranty Trust Company, under a collateral pledge agreement (R. 9), and under its common-law rights, claimed a set-off or banker's lien (R. 19-41). With respect to this he made the following finding (R. 21-22):

> "And the court further finds that the Guaranty Trust Company has in its hands the sum of $23,724.60 in cash, belonging to Herbert S. Daniel, trustee of the above named bankrupt; that the said sum was accumulated by Herbert S. Daniel as receiver subsequent to February 12th, 1930, said moneys having been collected by said Guaranty Trust Company for and on behalf of said bankrupt estate from the Prudential Insurance Company of America on mortgages made by the bankrupt and sold to the Prudential Insurance Company of America, and *that said Guaranty Trust Company has not made herein any claim to the said fund of $23,724.60, and has no claim to the said fund,* or to any part thereof, and is merely holding the said sum of $23,724.60 as custodian and agent of Herbert S. Daniel, as trustee of the above named bankrupt, and that said sum should be delivered forthwith to said trustee."

Upon these findings the referee entered a summary turnover order, amounting in substance to an affirmative money judgment, in the following terms (R. 22):

> "And It Is Further Ordered That the Guaranty Trust Company of New York, the applicant herein, be, and it is hereby *ordered and directed to forthwith pay over to Herbert S. Daniel*, as trustee of the above bankrupt estate, the sum of $23,724.60, of moneys in the hands of said Guaranty Trust Company of New York, belonging to Herbert S. Daniel, trustee of said bankrupt estate, *with interest thereon at the rate of 7 per cent per annum from this date.*" (Italics ours.)

The Guaranty Trust Company prosecuted a petition for review of this portion of the order to the District Court at Omaha, which affirmed the order after striking out the provision as to payment of interest (R. 26). From this affirmance the Guaranty Trust Company appealed to the Circuit Court of Appeals.

Among the assignments of error were included the absence of jurisdiction in the referee to determine a counterclaim wholly unrelated to the original petition, and the fact that the referee's order was erroneous and void:

> "* * * for the reason that said Guaranty Trust Company was, on the face of the record, in possession of said money outside of and beyond the territorial jurisdiction of said bankruptcy court, *and was and is an adverse claimant thereof entitled to its day in court in a plenary action in some court having jurisdiction of its person and of the said funds in its possession*" (R. 33). (Italics ours.)

The Circuit Court of Appeals unanimously reversed the District Court and held that the referee had no jurisdiction to make the order complained of. The present petition for certiorari brings up the propriety of this reversal.

## Question Presented.

The question presented to this Court is: Did the respondent, by filing with the referee a petition for reclamation of certain specific property in the possession of the trustee in bankruptcy, thereby submit to the summary jurisdiction of the referee for all purposes, so as to enable the referee to entertain and adjudicate a counterclaim wholly unrelated to the petition for reclamation, and to enter an order giving summary judgment for a sum of money adversely claimed by respondent, outside the territorial jurisdiction of the bankruptcy court?

## Summary of Argument.

The trustee contends that the filing of the petition for reclamation (the only affirmative step taken by respondent) amounted to a general submission for all purposes to the summary jurisdiction of the referee, and opened the door to an adjudication by the referee of claims by the trustee (wholly unrelated to the reclamation proceeding) which could otherwise have been tried only in a plenary suit. It is our contention, and the Circuit Court of Appeals has held, that the filing of such a petition has no such effect, that the referee was without jurisdiction to proceed, over the protest of respondent, to adjudicate, in a summary manner, the claim of the trustee, and that the trustee should be left to his proper remedy by plenary suit.

We accordingly urge, in the first place, that the referee had no jurisdiction to entertain the trustee's counterclaim in the first instance, since it appeared on the face of the pleadings that it had nothing to do with the subject-matter of the reclamation proceeding, and that he should have granted our motion to strike out that counterclaim (*infra*, pp. 10-23).

In the second place, assuming that the referee could properly proceed to investigate the merits of the counterclaim,

we urge that he should nevertheless have subsequently declined jurisdiction when it appeared that the subject-matter of the counterclaim was not a *res*, or an admitted bank deposit, forming part of the bankrupt estate, but was a mere debt (*infra*, pp. 23-27). Related to this contention, but distinct from it, is our third point, that the referee (assuming he had jurisdiction in the first instance) was bound to decline jurisdiction when it appeared, as is shown by the record, that respondent had a *bona fide* claim of right, which was not fictitious or colorable, to the set-off claimed (*infra*, pp. 28-40).

Finally, we submit that even if it be assumed that the referee had jurisdiction to proceed, he exceeded his authority in entering what amounts to an affirmative money judgment against the respondent (*infra*, pp. 41-43).

## I.

**The referee erred in overruling respondent's motion to strike paragraph 8 from the trustee's answer. Irrespective of whether respondent had an adverse interest in the balance of the demand loan account claimed by the trustee, the referee had no jurisdiction to entertain such a counterclaim.**

A referee in bankruptcy is not in any sense a separate court, nor is he endowed with any independent judicial authority. He is merely an officer of the court of bankruptcy, having no power except as conferred by the order of reference or by the Act.

*Weidhorn* v. *Levy*, 253 U. S. 268, 271.

The reclamation proceeding brought by the respondent was, in effect, a proceeding in *rem*, partaking, except for its

summary character, of the legal aspects of an action in replevin. Such a proceeding is directed against property in the possession of the trustee in bankruptcy. To regain such property, a claimant must affirmatively establish his own right to possession by proving ownership absolute or qualified.

> *General Phonograph Corp.* v. *Fanning,* 6 F. (2d) 115 (C. C. A. 3rd, 1925).

It is not, however, our contention, as stated at pages 73-74 of petitioner's brief, that a proceeding for reclamation of property in the possession of the trustee is to be treated as an action at law for all purposes. It is a proceeding *sui generis,* of a summary nature.

A reclamation proceeding in bankruptcy can only be brought in the bankruptcy court at the domicile of the bankrupt, that is, the bankruptcy court having primary jurisdiction. The respondent in this case could not have instituted legal proceedings in any other court, nor could it have resorted to any other methods of obtaining possession of the bonds held by the trustee.

> *Hebert* v. *Crawford,* 228 U. S. 204;
> *Murphy* v. *John Hofman Co.,* 211 U. S. 562;
> *White* v. *Schloerb,* 178 U. S. 542.

See also *Isaacs* v. *Hobbs Tie & Timber Co.,* 282 U. S. 734, and *Remington on Bankruptcy,* Vol. 5, Secs. 2450 and 2352. This restriction and limitation on the respondent's choice of a forum is admitted at page 49 of petitioner's brief.

A consideration of the facts indisputably shows that the claim asserted by the trustee in paragraph 8 of his answer (R. 6) was in no way germane to the issues raised by the petition for reclamation of the bonds sold by respondent to the bankrupt. The account, to the balance of which the trustee asserted his claim, was a demand loan account, secured by the deposit by the bankrupt of certain mortgages

as collateral. Advances were made by respondent on that collateral. Payments made to respondent by the Prudential Insurance Company were, in turn, credited to the bankrupt in that account.

The Circuit Court of Appeals, in its opinion, stated:

> "The two proceedings were quite distinct. Appellant sought to recover certain bonds to which it claimed title. The trustee sought an order that appellant should pay over money of the bankrupt estate received by appellant, after bankruptcy. The proceedings would not have been more unrelated to each other if the trustee had sought an order on appellant for the delivery of books and papers such as was asked in *Babbitt* v. *Dutcher*, 216 U. S. 102, or an order for the examination of witnesses such as was asked in *Elkus, Petitioner*, 216 U. S. 115" (R. 42).

But the trustee, in his brief, contends that the respondent, by presenting a petition for reclamation of the bonds, appeared generally and submitted itself for all purposes to the summary jurisdiction of the referee (Petitioner's Brief, pp. 15, 19). We admit that the respondent submitted itself to the jurisdiction of the referee to determine any issues relating to the title to the bonds sought by it. We also admit that the respondent, by withdrawing its petition for reclamation, could not deprive the referee of whatever jurisdiction he might have obtained by virtue of the presentation of the petition. We therefore do not dispute the statement at page 59 of petitioner's brief that "respondent's withdrawal after the issues had been made up and the hearing entered upon did not defeat the jurisdiction, previously attached, to determine the issue raised by the answer of the trustee." We merely contend that jurisdiction such as to permit the referee to pass upon the affirmative and unrelated counterclaim included in the trustee's answer never "previously attached". Such jurisdiction was not "destroyed" or "defeated," for the reason that it never existed.

This is the sole issue presented upon this appeal. With respect to it the Circuit Court of Appeals stated:

> "We have been cited to no authority for the proposition that a creditor or other petitioner asking specific relief against a bankrupt's estate, as provided by the Bankruptcy Act, thereby becomes subject to summary orders by the referee in matters entirely disconnected from the subject matter of such claim or petition, and no such authority is believed to exist. Under the circumstances we think that the appellant's objections to the jurisdiction should have been sustained and the order of the court affirming the order of the referee will be *Reversed*" (R. 42).

In the absence of decided cases on this specific issue, the petitioner contends that such jurisdiction is derived from General Order XXXVII and Federal Equity Rule 30. According to the petitioner, General Order XXXVII makes all the rules of equity practice established by the Supreme Court of the United States applicable and determinative in a summary proceeding before a referee on a petition for reclamation. As a consequence petitioner argues that the trustee could take advantage of Equity Rule 30, which permits an answer to set up, without cross bill, any set off or counterclaim against the plaintiff which might be the subject of an independent suit in equity against him, regardless of whether or not it is related to, or arises out of, the matters stated in the bill of complaint.

General Order XXXVII, the cornerstone of the petitioner's argument, provides:

> "In proceedings in equity, instituted for the purpose of carrying into effect the provisions of the act, or for enforcing the rights and remedies given by it, the rules of equity practice established by the Supreme Court of the United States shall be followed as nearly as may be. In proceedings at law, instituted for the same purpose, the practice and procedure in cases at law shall be followed as nearly as may be. But the judge may, by special order in any case, vary the time allowed for

return of process, for appearance and pleading, and for taking testimony and publication, and may otherwise modify the rules for the preparation of any particular case so as to facilitate a speedy hearing."

A reading of this order clearly indicates that this Court did not have in mind summary proceedings *before a referee*. In the first place, throughout the General Orders this Court refers to proceedings in bankruptcy either by the word "proceedings" or "bankruptcy proceedings". See, for instance, General Order XII, which prescribes the duties of a referee. Secondly, proceedings in bankruptcy before a referee are *sui generis;* they are neither "proceedings in equity" nor "proceedings at law". In the third place, it is a strained construction to consider summary proceedings as proceedings "instituted for the purpose of carrying into effect the provisions of the act". And if one adopts the statement of the petitioner in the case at bar that summary proceedings before a referee at all times partake of the nature of equity proceedings and that General Order XXXVII is applicable to them, what is the significance of the phrase "*proceedings at law*"? It should be noted, moreover, that Order XXXVII provides that—

> "the *judge* may, by special order in any case, vary the time allowed for return of process, for appearance and pleading, and for taking testimony and publication."

In short, it is manifest that since the General Orders deal largely with the regulation of summary bankruptcy proceedings, this Court would not then provide that the general equity rules should be applicable, many of the provisions of which would be not only at variance with the purposes and language of the Bankruptcy Act and the General Orders but impossible of application. Because bankruptcy proceedings are *sui generis*, this Court simply desired to make it certain that plenary suits dealing with bankruptcy shall be guided by the ordinary rules rather than by any provisions in the General Orders.

But this question is no longer *de novo*. Courts have frequently and uniformly held that General Order XXXVII is not applicable to a summary proceeding.

*In re Cunney*, 225 Fed. 426 (D. C. Mass. 1904);
*International Harvester Co.* v. *Carlson*, 217 Fed. 736, 739 (C. C. A. 8th, 1914);
*In re Hughes*, 262 Fed. 500 (C. C. A. 2d, 1919);
*Bradley* v. *Huntington*, 277 Fed. 948 (C. C. A. 2d, 1921);
*In re Kenney & Greenwood*, 23 F. (2d) 681 (1928, D. C. Me.).

In *In re Cunney, supra*, at page 428, the District Court stated:

"It was not denied that the conduct of the bankrupts was indefensible, but it was urged that they have not the money now in their hands, and that they did not have it when the trustee filed his petition asking that they turn over the money to him. The bankrupt's counsel contended that by reason of General Order XXXVII (89 Fed. xiv, 32 C. C. A. xi) the statements made by the bankrupts in their sworn answer to this petition must be taken as true, unless controlled by the testimony of two witnesses, or by that of one witness with corroborating circumstances. This contention is without force in the case at bar. General Order XXXVII applies only to equity proceedings, properly so called, and not to summary proceedings in bankruptcy like this. Even in summary proceedings the court allows the respondent full opportunity for hearing and defense, but it is not limited by the technical rules of procedure in equity."

And in *International Harvester Co.* v. *Carlson, supra*, at page 739, the Circuit Court of Appeals for the Eighth Circuit said:

"Counsel for the objecting creditor insists that rule 37 of the bankruptcy rules makes the general equity rules prescribed by the Supreme Court applicable to proceedings in bankruptcy, and that by equity rule 66 (198

Fed. xxxvii, 115 C. C. A. xxxvii) the time for filing exceptions to the report of masters is fixed at 20 days. *We do not think that the general equity rules can be applied as rules of court in the performance of the administrative work of courts of bankruptcy. They may be looked to for analogies, but not as rules. The Supreme Court itself has fixed the rules to govern courts of bankruptcy.* To hold that the District Court was bound by the report of the referee, because exceptions were not filed within 20 days, would deprive that court of its duty both under the bankruptcy law and the rules of the Supreme Court to pass upon the question of the bankrupt's right to his discharge." (Italics ours.)

*Remington on Bankruptcy*, in Vol. 1, Sec. 31, states:

> "This General Order has been construed to refer only to suits and proceedings other than the proceedings in bankruptcy themselves, in other words to suits and proceedings brought in the Federal Courts in aid of bankruptcy proceedings; as, for example, suits in equity or at law to recover preferences, set aside fraudulent transfers, etc., even though this General Order was prescribed at a time when the Federal Courts had no jurisdiction of bankruptcy suits per se but only of suits where diversity of citizenship might exist as in other Federal cases."

The Circuit Court of Appeals, in its opinion in the case at bar, likewise concluded that General Order XXXVII is not applicable to summary proceedings (R. 41). Citing and quoting from *Weidhorn* v. *Levy*, 253 U. S. 268, the Court pointed out that in the provisions of the General Orders summary proceedings are referred to by the word "proceedings" and never by the words "proceedings in equity" and "proceedings at law" (R. 41).

But despite all this the "petitioner maintains that General Order XXXVII does not admit of such interpretation" (Br. p. 39).

Consequently, if the provisions of General Order XXXVII are not applicable to summary proceedings, the provisions of Equity Rule 30 may be disregarded. Nor is there need to consider here the soundness of the construction by some

courts that even the broad language of Equity Rule 30 does not allow a cause of action to be pleaded as a counterclaim if it could not have been made the subject of a cross bill prior to the adoption of the rule. On this point we admit the argument presented by the petitioner at pages 41 to 46 of his brief.

Recognizing perhaps the weakness of his contention that General Order XXXVII is applicable to the summary jurisdiction of the referee in this case, the petitioner argues that apart from General Order XXXVII and Equity Rule 30 a referee in bankruptcy should on general principles be given jurisdiction in a reclamation proceeding to pass on any and all counterclaims interposed by the trustee, whether these are related or unrelated to the subject matter of the petition for reclamation (Petitioner's Brief, pp. 46, *et seq.*). We submit, however, that there is no public policy that demands such a limitless extension of the power of a referee in bankruptcy, particularly in view of the fact that respondent, if it desired to assert its right to the possession of the bonds claimed, had no choice save to appear before the referee of the bankruptcy court having primary jurisdiction.

In fact, what would be the effect of a rule such as that urged by the petitioner? To hold that a person who believes he has title to property in the possession of a trustee in bankruptcy and who files a petition for its reclamation (the only remedy available to him), must thereby submit all his dealings with the bankrupt to the summary jurisdiction of the referee and must forego all rights granted him by law in a plenary suit, would result in the imposition of an unfair burden. It would require the claimant to choose between an abandonment of his right to recover the specific property held by the trustee and an abandonment of his right to have the trustee's independent claims against him adjudicated in a plenary suit. The choice thus forced upon him is more than a mere choice between different tribunals, such as any ordinary litigant must make when by filing suit he opens the door to counterclaims which would otherwise be triable in a different forum. It is a choice, not between tribunals,

but between the ordinary process of law in a plenary suit and the summary process of a referee's hearing. Petitioner has cited no authority, and the Circuit Court of Appeals found none, to support the contention that such a choice should be imposed upon persons having dealings with a bankrupt estate. Obviously, in requiring plenary suits in certain cases, Congress in the enactment of the Bankruptcy Act and the courts in its application have considered the rights of a party in a plenary action as of some consequence, even though such plenary actions may occasionally delay complete administration of the bankrupt estate. Speed in administration is not the sole consideration, as one is led to believe from petitioner's argument (Br., p. 60). *Cf. In re Lummus*, 214 Fed. 891.

The petitioner, in arguing that the referee had jurisdiction of the counterclaim presented in paragraph 8 of the trustee's answer, states on page 56 of his brief that "equitable terms may be imposed by a court *as a condition of granting an order of reclamation*". We may concede the soundness of this principle; but we submit it is not applicable to the case at bar. We likewise admit the statement at page 62 of petitioner's brief that:

> "Courts of bankruptcy in exercise of their equity powers act *in personam* and have summary jurisdiction where a party voluntarily appears or can be served with process, regardless of the location of the *res* or domicile of the party."

But this statement presumes that the respondent voluntarily appeared to adjudicate not only its own claim to the bonds, but also the counterclaim presented in the answer of the trustee, or that the respondent could have been served with process within the jurisdiction of the bankruptcy court. The record shows that neither of these facts is true in the case at bar.

In further support of his argument that the referee had jurisdiction to pass on the counterclaim asserted by the trustee, petitioner states in the heading at page 50 of his brief:

"The appellant, by coming into the Bankruptcy Court and seeking affirmative summary relief, thereby gave the court jurisdiction of its person, as to such issue, and all such defenses, including affirmative claims, that may be properly litigated in that summary proceedings. Consent thus given cannot be withdrawn so as to deprive the court of jurisdiction so obtained."

And the petitioner cites in his brief, at pages 50 to 55, the following decisions as substantiating this heading:

*Operators Piano Co.* v. *First Wisconsin Trust Co.*, 283 Fed. 904 (C. C. A. 7th, 1922);
*In re Bennett*, 285 Fed. 351 (C. C. A. 7th, 1922);
*In re Pennsylvania Coffee Co.*, 8 F. (2d) 98 (D. C. W. D. Penn., 1925);
*Triangle Electric Co.* v. *Foutch*, 40 F. (2d) 353 (C. C. A. 8th, 1930);
*In re Dernburg & Son, Inc.*, 5 F. (2d) 37 (C. C. A. 2nd, 1924);
*In re Barnett*, 12 F. (2d) 73 (C. C. A. 7th, 1926).

The petitioner relies heavily upon *Operators Piano Co.* v. *First Wisconsin Trust Co., supra.* This case, however, is not in point. To begin with, the decision involved jurisdiction of a District Court over a plenary suit under Section 23b of the Bankruptcy Act. No summary proceeding was involved. The extract from the opinion quoted at pages 50 and 51 of petitioner's brief is pure dictum. It is clear from the broad general language used by the Court in its opinion that it did not intend to cover a situation such as that at bar. It should be noted, moreover, that the Court uses the phrase "affirmative claims" only as connected with a defense to a claim,—in other words, as something related to, and used to defeat, the claim of the petitioner for relief in the summary proceeding, not as something which may give rise to an independent affirmative judgment. Likewise, the use of the word "counterclaim" by the Court in this *dictum* implies a right grow-

ing out of the transaction for which the petitioner is seeking relief.

In *In re Bennett,* 285 Fed. 351, the sole question determined was the jurisdiction of the referee to settle, in a summary proceeding against the trustee and a company, a controversy over an interest in that company. The Court decided that the referee had no jurisdiction. It is apparent that the case has nothing to do with an unrelated counterclaim presented in a petition for reclamation of specific property.

The extract quoted at page 51 of petitioner's brief is purely argumentative. The presentation of the extract *in toto* destroys the value of the case for the contention of the petitioner. The Court in its opinion states (285 Fed. at p. 352):

> "We think the case comes within the holdings of the long list of cases that deny to the bankruptcy court authority to dispose of controverted issues of this character in a summary proceeding against the objection of the adverse party. Bryan v. Bernheimer, 181 U. S. 188, 21 Sup. Ct. 557, 45 L. Ed. 814; Mueller v. Nugent, 184 U. S. 1, 22 Sup. Ct. 269, 46 L. Ed. 405; Babbitt v. Dutcher, 216 U. S. 102, 30 Sup. Ct. 372, 54 L. Ed. 402, 17 Ann. Cas. 969; Bardes v. Hawarden Bank, 178 U. S. 524, 20 Sup. Ct. 1000, 44 L. Ed. 1175; First Nat. Bank v. Chicago Title & Trust Co., 198 U. S. 280, 25 Sup. Ct. 693, 49 L. Ed. 1051.
>
> But two possible reasons can be suggested why this rule should not be invoked. It may have been contended that Collins' petition for leave to sue the trustee and to require him to appear in the New York court conferred jurisdiction on the bankruptcy court to dispose of the merits of this controversy. We have consistently upheld the jurisdiction of the bankruptcy court to determine controversies, either in summary or in plenary proceedings, where the adverse party either invokes the jurisdiction or consents to a trial of the disputed issues in such a proceeding. Operators' Piano Co. v. First Wisconsin Trust Co. (C. C. A.) 283 Fed. 904. And we may add that we think greater business efficiency and a more speedy administration of estates, together with greater uniformity in rulings, would be attained if all such controversies could, regardless of the objection of the ad-

verse party, be determined in the bankruptcy court; the court having jurisdiction to administer the bankrupt estate. *But such an end can only be secured by legislation. We must construe the law as it stands.*

*Under the law as it exists, Collins had the right to litigate this question either in the state court or before the referee in bankruptcy. Against his objection, it could not be determined in summary proceeding by the referee.*" (Italics ours.)

*In re Pennsylvania Coffee Co.*, 8 F. (2d) 98, also cited by petitioner, does not involve a summary proceeding in bankruptcy. The petition was filed as a plenary suit. The matter was merely referred to a referee *as special master* to take testimony and report the facts to the Court. Furthermore, it should be noted that the order of the Court to turn over certain moneys to the trustee was made on a new petition filed by the trustee and not in the original petition filed by the claimant against the trustee. But apart from the fact that a new petition was filed, the case in substance is simply an application of the principle that the Court has power to disallow a claim unless the claimant is willing to perform certain conditions imposed by the decree. In that case the claimant had received what constituted a preference under an assignment directly related to the subject matter of the original claim. This was the subject of the turnover order.

Similarly in *Triangle Electric Co.* v. *Foutch*, 40 F. (2d) 353, no petition for reclamation of specific property in a summary proceeding was involved. The case involved merely an ordinary proof of claim, to which the trustee interposed a counterclaim. Moreover, the counterclaim presented by the trustee was related to the original claim. In addition, the order of the referee was not an affirmative order unconditionally directing the claimant to return to the trustee the specific property which the trustee sought. The order merely states that:

"The claim should be allowed with the proviso, that, if the claimant shall, within a specified time, fixed by the

court, return to the trustee the car load of merchandise described and mentioned in the objections, or the cash value of the same, that then the claim should be allowed in full" (p. 354).

The direct question involved in *In re Dernburg & Son., Inc.*, 5 F. (2d) 37, was the jurisdiction of a referee in bankruptcy to inquire into defenses interposed by the trustee against claims of creditors who had received preferences or to whom conveyances, transfers, assignments or encumbrances, void or voidable under Section 67(e) had been made. Section 57(g) of the Bankruptcy Act specifically provides that such claims shall not be allowed unless the creditors shall surrender their preferences, conveyances, transfers, assignments or encumbrances. It is quite apparent that decisions of this nature do not strengthen the contention of the petitioner that the referee in the case at bar had jurisdiction of the counterclaim asserted in paragraph 8.

In *In re Barnett*, 12 F. (2) 73, the order of the referee was not an order granting affirmative relief such as that granted in the case at bar. In that case the referee allowed a claim filed against the estate on condition that the claimant turn over certain bonds in his possession belonging to the bankrupt. It is one thing for a referee, as a condition precedent to the granting of relief to a claimant in reclamation proceedings, to require the claimant to satisfy an outstanding demand of the trustee. It is an altogether different thing for a referee, by an absolute and unconditional order, to require a claimant, to whom no relief is granted, to satisfy "forthwith" an independent, and disputed, counterclaim. The cases cited by petitioner are authority only for the first of these propositions, with the soundness of which this Court need not now be concerned. Upon the second proposition (which is the one here involved) those cases are not in point.

In conclusion, it can be stated that the cases relied upon by the petitioner to substantiate the principle stated at page 50 of his brief are not applicable to our case. The opinion of the Circuit Court of Appeals need not be altered:

"We have been cited to no authority for the proposition that a creditor or other petitioner asking specific relief against a bankrupt's estate, as provided by the Bankruptcy Act, thereby becomes subject to summary orders by the referee in matters entirely disconnected from the subject matter of such claim or petition, and no such authority is believed to exist." (R. 42).

## II.

**Assuming that the referee did not err in overruling respondent's motion to strike out paragraph 8 of the trustee's answer, the referee should nevertheless have subsequently dismissed the counterclaim when it appeared that the subject matter of the counterclaim was not a specific *res*, or an admitted bank deposit, but was in effect merely an alleged debt.**

The petitioner, we assume, will admit that unless the property involved is within the territorial jurisdiction of the bankruptcy court or the respondent is subject to its process, the referee has no jurisdiction. As to the former basis of jurisdiction, the petitioner presumably admits that the balance of the demand loan account, be it considered as a mere debt or as property in tangible form, has not its situs in Nebraska. And as to the latter basis of jurisdiction, it is not disputed that personal jurisdiction over the respondent could not have been obtained by any court in Nebraska, for the respondent was neither qualified to do business within the state nor did it have a place of business or agent therein. Hence, the only means for the referee to obtain jurisdiction over the respondent was by reason of its having filed a petition for reclamation of the bonds. This, we believe, the referee could not do.

But granting for the sake of argument that the referee did thereby obtain jurisdiction, he is nevertheless still sub-

ject to and restricted by the general limitations imposed by the Bankruptcy Act upon his summary jurisdiction.

The record in this case discloses that the sum for which the petitioner counterclaims arose as follows: Prior to the filing of the petition in bankruptcy, the respondent loaned to Peters Trust Company from time to time certain sums, receiving from it in return certain notes and mortgages as collateral. Exercising a privilege which the petitioner does not dispute, the respondent from time to time disposed of these notes and mortgages (as the Prudential Insurance Company took them up) and credited the proceeds to the Peters Trust demand loan account. Under its collateral pledge agreement respondent also credited to this account the amount standing with it on deposit in the checking account, with the result that the subsequent disposal by the respondent of such of the collateral notes and mortgages as remained in its hands when the petition in bankruptcy was filed ultimately created a balance in the petitioner's favor, the right to which balance, less a part payment thereon, is the present subject of dispute. This balance at no time formed a part of the checking account, and was never carried or regarded by the parties as a "deposit."

It is submitted that these facts lead to three conclusions:

(a) That the sum in dispute cannot be viewed as a bank deposit in the sense in which that term is used in the cases holding that for bankruptcy purposes a bank deposit is to be distinguished from an ordinary debt.

(b) That the admitted right of the respondent not only to dispose of the notes and mortgages, but to credit the proceeds against the loan account, negatives any contention that the respondent was under a duty to keep these funds separate and distinct or that principles of trust or agency may be applied.

(c) That the correct view of the transaction is that of a running account whose reduction to a balance has therefore placed the parties in a simple debtor-creditor relation.

This being so, the instant case is squarely within the rule that a referee in bankruptcy is without jurisdiction to entertain a summary proceeding for the collection of a debt, whether disputed or not, since even an admitted debt (and *a fortiori* a debt which is disputed) is not a *res* and cannot be made the subject of a summary turnover order. This rule is exemplified in the following cases:

*In re Haley,* 158 Fed. 74 (C. C. A., 6th, 1908), appeal dismissed 209 U. S. 546. Here the trustee of a bankrupt corporation sought to assert in summary proceedings liability for the corporation's debts against a stockholder of the corporation who had subscribed to its stock with knowledge of its fraudulent overvaluation. In denying jurisdiction, the Court said, at page 78:

> "A court of bankruptcy has no jurisdiction of a suit at law or in equity brought by a trustee to recover property *or collect debts,* or to set aside transfers of property alleged to be fraudulent, except by consent of the defendant."

*In re Howe Manufacturing Company,* 193 Fed. 524 (D. C., W. D., Ky., 1912). Speaking of a summary proceeding brought by the trustee of a bankrupt corporation to enforce liability for an unpaid stock subscription, the Court said at page 528:

> "If in a proceeding in bankruptcy proper the trustee could intrude a separate suit against every debtor of the bankrupt no difference what the demand might be, we should have a conglomeration of issues of the most remarkable extent and character in a bankruptcy proceeding. Nothing of the sort was contemplated by Congress, nor provided for by the act. On the contrary, the trustee, if he succeeds to the rights of the bankrupt, must do as the latter would have been compelled to do, and, if he have any claim to property or any right to recover upon any indebtedness alleged to be due from another person, he must, like every other litigant, institute his own separate and independent action in a court having jurisdiction of the subject-matter, and have his claim regularly adjudicated in due course of law. Being

a trustee in bankruptcy gives him no special privileges in the courts. He stands there like other people. These general propositions seem to admit of no doubt. There are cases, however, which are exceptional, and in them summary proceedings may be resorted to, for example, in cases where property is in the possession of the trustee and therefore in *custodia legis*. If that possession is interfered with, summary action is admissible, and where the bankrupt refuses, or some agent of his refuses, to deliver to the trustee property belonging to the estate, a similar course is open. But these exceptions do not embrace cases where there are adverse claims to the property made in good faith, *nor those in which there is an outstanding indebtedness of any character.* Nor do they embrace a case where a third person has the property in his possession claiming it adversely, nor a case where recovery on a contract is sought, for in respect to all such cases it cannot be said that the debtor is in 'possession' of any property of the estate within the rule as to summary proceedings." (Italics ours.)

*In re Ballou,* 215 Fed. 810 (D. C. E. D. Ky., 1914). Here the trustee in bankruptcy sought to enforce against a corporation the specific performance of its contract to pay the bankrupt in stock for services performed by him. Denying this right, the Court said at page 813:

> "I am, however, clear that the referee had no jurisdiction of the proceeding, and that it is not now too late to raise the question. This was not a case for a summary proceeding. A summary proceeding is proper only to effect the transfer of the physical possession of property from the bankrupt or a third person to the trustee. It is not proper to enforce the performance by a third person of a contract with the bankrupt. *An undisputed debt due the bankrupt cannot be collected by a summary proceeding* * * * No instance can be found, I dare say, where the payment of a debt due or the specific performance of a contract with the bankrupt has been enforced in any such way."

Remington supports this view when he says in his treatise on bankruptcy, in Vol. 5, Sec. 2350, as amended by his Supplement of September, 1930:

"The determination of the questions, first, as to whether or not the property is merely a debt, and, second, if not a mere debt, as to who has possession or control of it, determines the forum to which the parties must resort to work out their rights and the manner of procedure, as to whether summary or plenary.

"* * * or if the property does not exist in tangible form, but is a mere debt owed by a third party, then such third party need not come into the bankruptcy proceedings for his rights, and the trustee cannot bring him into the proceedings and he is entitled to be heard in plenary action."

An examination of the cases cited in petitioner's brief to deny the existence of this rule indicates that they are not applicable to the facts here. *May* v. *Henderson,* 268 U. S. 111 (1925), and *In re Davis,* 119 Fed. 950 (D. C., W. D., Tex., 1903), are inapplicable not only because they concern ordinary bank deposits rather than balances of running loan accounts, but because in each case the deposit was taken with notice of the fact that it was a fund specifically set aside for creditors.

*Reed* v. *Barnett National Bank,* 250 Fed. 983 (C. C. A., 5th, 1918), is similarly inapplicable in that it involved an ordinary bank deposit taken with knowledge of the depositor's insolvency.

*Knapp & Spencer Co.* v. *Drew,* 160 Fed. 413 (C. C. A., 8th, 1908), and *In re Walker Grain Co.,* 295 Fed. 120 (C. C. A. 5th, 1923), simply affirm the familiar rule that a summary proceeding will lie to compel the return of money accepted by a creditor with knowledge of his debtor's insolvency.

*In re Radley Steel Const. Co.,* 212 Fed. 462 (D. C., E. D., N. Y., 1914), is inapplicable both because it deals only with a bank deposit and because the decision supports the respondent's contention that jurisdiction may be defeated by a bona fide adverse claim.

## III.

**Assuming that the counterclaim of the trustee is for property existing in tangible form, the referee is nevertheless bound to make inquiry as to whether the respondent has an adverse interest in such property. The record discloses that the respondent has an adverse interest which precluded the referee from proceeding further on the counterclaim.**

If the counterclaim of the trustee relates to property existing in tangible form (which may be made the subject of a summary turnover order), the principles governing the jurisdiction of the referee are firmly fixed by adjudication. In short, if the possession, actual or constructive, of the property is in the bankrupt or his agent or in some one not claiming a beneficial interest in it, or is in the receiver, marshal or trustee in bankruptcy, the bankruptcy court has summary jurisdiction over it and may summarily order its surrender or delivery, may bring all parties claiming interests in it into court, and may determine all rights to it. If, on the other hand, some third party claiming a beneficial interest in the property has possession, the trustee cannot bring him into the bankruptcy proceedings. Such a party is entitled to be heard in a plenary action. See *Remington on Bankruptcy*, Vol. 5, Sec. 2350.

We admit, however, the contention of the petitioner (Br. pp. 22-25), that the mere assertion of an adverse interest by the party in possession of the property does not *ipso facto* deprive the referee of jurisdiction. The referee is vested with the power to determine whether the claim is substantial or merely colorable, frivolous or baseless. But if the adverse interest asserted by the party in possession of the property is found to be substantial and not colorable, the jurisdiction of the referee thereupon terminates. A plenary suit must then

be instituted. In fact, this principle is admitted by the petitioner in his brief (p. 20). The principle is well settled.

*May* v. *Henderson*, 268 U. S. 111;
*In re Selfridge*, 33 F. (2d.), 800 (D. C. Mass. 1929);
*Shea* v. *Lewis*, 206 Fed. 877 (C. C. A. 8th, 1913);
*Board of Education* v. *Leary*, 236 Fed. 521 (C. C. A., 8th, 1916);
*Priest* v. *Weaver*, 43 F. (2nd.), 57 (C. C. A. 8th, 1930);
*Johnston* v. *Spencer*, 195 Fed. 215 (C. C. A. 8th, 1912);
*Gamble* v. *Daniel*, 39 F. (2d.), 447 (C. C. A. 8th, 1930).

It would appear from the record in the case at bar that the referee found that the respondent had no adverse claim to the balance in the demand loan account (*supra*, p. 7; R. 21), and that upon this point the Circuit Court of Appeals has apparently approved his findings (R. 40).

We submit that the finding of the referee and the statement in the opinion of the Circuit Court of Appeals in this respect are erroneous.

The record upon which this finding is based is of course an *ex parte* record made up wholly of testimony and exhibits introduced by the trustee, and presenting only that side of the case which is most adverse to respondent. Respondent's counsel, relying (rightly or wrongly) upon their preliminary motion attacking the referee's jurisdiction, withdrew from the hearing; and the record consequently contains none of the evidence, and none of the explanations which might have been elicited by cross examination, upon which respondent's defense on the merits is based. Yet even upon the record as it stands (that is, upon the trustee's own uncontradicted version) we submit that a showing has been made of an adverse claim sufficient to oust the jurisdiction of the referee.

In this connection it should be noted that the referee's findings in this case are not based upon conflicting testimony, but are merely inferences from facts which (upon this record) must be taken as uncontradicted. In such a case there is no ground for applying the ordinary rule that an appellate court will defer to the findings of the original trier of the facts who saw the witnesses and was in a position to gauge their credibility. As was said in *In re Solof*, 2 F. (2d) 130, 132 (C. C. A. 9th):

> "No doubt, findings by a referee in bankruptcy are presumptively correct and will not be disturbed, unless they are clearly against the weight of the evidence, or some obvious error of law has intervened in its application. This rule, however, has little application to inferences to be drawn from admitted facts."

*Cf. Walter* v. *Atha*, 262 Fed. 75 (C. C. A. 3rd).

The principle enunciated in the foregoing cases is particularly applicable to the case at bar, since here the referee's "finding" upon the claim of adverse interest was in reality a conclusion or inference of law, going to the question of his jurisdiction, which is always open to review.

Throughout this litigation it has been constantly stated that the balance in the demand loan account claimed by the petitioner was accumulated by the respondent subsequent to the date of adjudication of the bankrupt, namely December 10, 1929. For instance, that fact was alleged by the trustee in paragraph 8 of its answer (R. 6). The evidence presented to the referee in the hearing on the petition for reclamation emphasizes the same fact. (R. 12, 14). As pointed out, *supra*, at page 7 the referee stated in his findings that the balance was "accumulated by Herbert S. Daniel as receiver subsequent to February 12th, 1930" (R. 21). And the Circuit Court of Appeals, in its opinion, proceeded upon the same assumption.

The petitioner's brief in this Court pursues the same argument, stating in the heading at page 25:

> "A claimant cannot acquire an adverse interest in property belonging to the bankrupt's estate that comes into his possession after adjudication in bankruptcy."

Again at page 73 it is stated that "deposits made *after* the filing of bankruptcy can never be used as a setoff". Similarly at page 75 it is stated that "in the case at bar, the money was collected long after bankruptcy when no right of setoff could attach".

Yet it appears beyond question from the record that the respondent on November 25, 1929, held certain mortgages as collateral for advances amounting to $156,700 which it had already made to the bankrupt. At no time subsequent thereto did the bankrupt deposit additional mortgages. The various amounts of money collected by the respondent as the mortgages were sold were merely a transformation of the collateral. Whatever rights the respondent possessed had their inception at a time not only prior to the adjudication of the bankrupt but also prior to the filing of the petition in bankruptcy. This appears from Exhibit A filed by the petitioner in the referee's proceedings (R. 18-19). A correct understanding of the nature of the demand loan account maintained by the bankrupt with the respondent (see *supra*, pp. 8, 24) renders irrelevant much of the argument presented by the petitioner in his brief.

The record, even as prepared in the absence of the respondent, discloses the existence of a *bona fide* adverse interest of the respondent in the balance in the demand loan account. The referee in bankruptcy is bound to inquire whether the party in possession of the property has an adverse interest (*Remington on Bankruptcy*, Vol. 5, Sec. 2438). And in this inquiry the referee is to consider not only the pleadings but the entire record. This follows by force from the established principle that a referee is not precluded from proceeding to determine whether an adverse

interest alleged in the pleadings by the party in possession is substantial or merely colorable.

*May* v. *Henderson*, 268 U. S. 111;
*In re Radley Steel Construction Co.*, 212 Fed. 462 (D. C. E. D. N. Y. 1914);
*Matter of Yorkville Coal Co.*, 211 Fed. 619 (C. C. A. 2d., 1914);
*First Nat. Bank* v. *Hopkins*, 199 Fed. 873 (C. C. A. 5th, 1912).

If the determination of the existence of an adverse claim must be made from the whole record, it is not necessary for the respondent to have asserted its adverse claim in the pleadings. In fact, it appears from the answer of the trustee that the respondent asserted an adverse claim in the balance in the demand loan account. The trustee, at the hearing before the referee on the petition for reclamation, asked leave to amend his answer by adding paragraph IX. This amendment was granted (R. 9). The amendment reads as follows:

> "The trustee further alleges that with full knowledge of all the facts alleged in the applican't petition, the applicant ratified and confirmed the sale of said securities *by attempting to impress a lien on the funds belonging to the bankrupt estate on deposit with the applicant, and is estopped to now reclaim said securities from the undersigned trustee.*" (Italics ours.)

But apart from this, it can not be disputed that the respondent at the hearing before the referee did assert an adverse claim in the balance in the demand loan account. After the referee overruled its motion to strike paragraphs 7 and 8 from the answer of the petitioner, counsel for the respondent stated:

> "We will file a dismissal of this reclamation proceeding. In other words, from the very first our position has been that *it has been immaterial whether we keep the*

*money in New York under the collateral pledge agreement,* or whether we get the bonds. Now if Mr. Daniel, the trustee, is allowed to come in here and in his answer bring up these different issues, and if these other people are allowed to come in this lawsuit, as far as we are concerned, why we will dismiss the action. Now of course there isn't any counterclaim, this isn't the same as a counterclaim, because we are merely asking for the custody of the bonds. Mr. Daniel has no right to come in when we ask for the custody of the bonds, and bring up a new issue" (R. 9). (Italics ours.)

In effect, the dismissal of the reclamation proceeding is an assertion of an adverse claim in the balance in the demand loan account. The petitioner admits that the bonds shipped to Peters Trust Company have never been paid for, and admits that the purchase price was due from the bankrupt estate (R. 5-6). As to this we submit that respondent had two alternatives: *first,* to claim title to the specific bonds and attempt to recover them in the reclamation proceedings; or *second,* to abandon title to them and set off the purchase price against the balance in the demand loan account. It is clear from the action of counsel for the respondent that the respondent was abandoning its claim of title to the bonds sold to the bankrupt and had charged the sale price of such bonds against the demand loan account by virtue of the lien it possessed under the provisions of the collateral loan agreement entered into by the bankrupt at the time it opened the demand loan account with the respondent.

In addition, it plainly appears from Exhibit A filed by the trustee in the hearing before the referee that the respondent did assert an adverse claim in the balance in the demand loan account. It is stated in Exhibit A:

"Excess collateral to loan $3,272.20 against which, however, there was a charge of $23,055.82 representing a claim transferred from Guaranty Company of New York on November 27, 1929" (R. 18).

Again it appears in Exhibit A (R. 19):

"Against the above, however, there is a lien on account of claim assigned November 27, 1929, by Guaranty Company of New York of

| | |
|---|---|
| Principal | $23,055.82 |
| Interest on above | 385.22 |
| Total Debit | 23,441.04 |
| March 14, 1930, Balance due Peters Trust Co. | 7,783.56 |
| | $31,224.60 |

We submit, therefore, that a finding by the referee that the respondent had not asserted and did not have any adverse claim to the balance sought by the petitioner, if such is the finding of the referee, is clearly erroneous. The statement appearing in the opinion of the Circuit Court of Appeals (R. 40) is likewise erroneous. The record, as we have seen, conclusively shows the assertion by the respondent of an adverse claim in the balance sought by the petitioner.

Granting that the referee is empowered to inquire into the adverse claim to determine whether it is substantial or colorable, we submit that it cannot be held that the claim of the respondent in the case before this Court was colorable, frivolous or baseless.

It is well settled that a claim in a bankruptcy proceeding is deemed to be substantial when the claimant's contention discloses a fair and reasonable doubt either as to the facts or the law. An adverse claim is considered substantial unless the preliminary inquiry shows that it is so obviously insufficient either in fact or in law as to be plainly without color or merit and to be a mere pretense.

*Harrison* v. *Chamberlain*, 271 U. S. 191 (1926);
*In re Midtown Contracting Co.*, 243 Fed. 56 (C. C. A., 2d, 1917);
*Boyle* v. *Gray*, 28 F. (2d) 7 (C. C. A., 1st, 1928);
*In re Wood*, 278 Fed. 355 (C. C. A. 2d, 1921);
*In re Radley Steel Construction Co.*, 212 Fed. 462 (D. C. E. D. N. Y., 1914).

This Court has succinctly summarized the elementary rules of law controlling the case at bar. In its opinion in the case of *Harrison* v. *Chamberlain*, 271 U. S., at pages 193-195, the Court stated:

"It is well settled that a court of bankruptcy is without jurisdiction to adjudicate in a summary proceeding a controversy in reference to property held adversely to the bankrupt estate, without the consent of the adverse claimant; but resort must be had by the trustee to a plenary suit. *Mueller* v. *Nugent*, 184 U. S. 1, 15; *Louisville Trust Co.* v. *Comingor*, 184 U. S. 18, 24; *Jaquith* v. *Rowley*, 188 U. S. 620, 623; *Schweer* v. *Brown*, 195 U. S. 171, 172; *Galbraith* v. *Vallely*, 256 U. S. 46, 48; *Taubel Co.* v. *Fox*, 264 U. S. 426, 433; *May* v. *Henderson*, 268 U. S. 111, 115; *Board of Education* v. *Leary* (C. C. A.), 236 Fed. 521, 524; *Lynch* v. *Robertson* (C. C. A), 287 Fed. 433, 435, 437. However, the court is not ousted of its jurisdiction by the mere assertion of an adverse claim; but, having the power in the first instance to determine whether it has jurisdiction to proceed, the court may enter upon a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable. And if found to be merely colorable the court may then proceed to adjudicate the merits summarily; but if found to be real and substantial it must decline to determine the merits and dismiss the summary proceeding. *Mueller* v. *Nugent, supra*, 15; *Louisville Trust Co.* v. *Comingor, supra*, 25; *Taubel Co.* v. *Fox, supra*, 433; *May* v. *Henderson, supra*, 16; *Board of Education* v. *Leary, supra*, 525; *Lynch* v. *Roberson, supra*, 436."

* * * * * * *

"Without entering upon a discussion of various cases in the Circuit Courts of Appeals in which divergent views have been expressed as to the test to be applied in determining whether an adverse claim is substantial or merely colorable, we are of opinion that it is to be deemed of a substantial character when the claimant's contention 'discloses a contested matter of right, involving some fair doubt and reasonable room for controversy,' *Board of Education* v. *Leary, supra*, 527, in matters either of fact or law; and is not to be held merely colorable unless the preliminary inquiry shows

that it is so unsubstantial and obviously insufficient, either in fact or law, as to be plainly without color of merit, and a mere pretense. Compare *Binderup* v. *Pathe Exchange*, 263 U. S. 291, 295; and *Moore* v. *New York Cotton Exchange*, 270 U. S. 593.

In the present case it clearly appears that the validity of the respondent's claim depended upon disputed facts, as to which there was a conflict of evidence, as well as a controversy in matter of law. Its determination involved 'fair doubt and reasonable room for controversy' both as to fact and law. It was therefore substantial, and not merely colorable; and its merits could only be adjudged in a plenary suit."

As a matter of fact, it has been held that a claim may be substantial even though it is fraudulent and voidable.

*Mueller* v. *Nugent*, 184 U. S. 1, 15 (1901);
*Johnston* v. *Spencer*, 195 Fed. 215, 220 (C. C. A., 8th, 1912);
*Harrison* v. *Chamberlain*, *supra*;
*Shea* v. *Lewis*, 206 Fed. 877 (C. C. A., 8th, 1913);
*Boyle* v. *Gray*, 28 F. (2d) 7 (C. C. A., 1st, 1928).

Courts have frequently held that the right asserted by a bank to set off a debt against deposits and accounts maintained with it by the bankrupt estate prior to the filing of the petition in bankruptcy is not a colorable and unsubstantial claim and that, therefore, a bankruptcy court does not possess summary jurisdiction to determine the rights in those deposits and accounts.

*In re Radley Steel Construction Co.*, 212 Fed. 462 (D. C. E. D. N. Y., 1914);
*In re Boston-Cerrillos Mines Corporation*, 206 Fed. 794 (D. C. N. M., 1913);
*First National Bank* v. *Hopkins*, 199 Fed. 873 (C. C. A., 5th, 1912).

If this Court considers the adverse claim of the respondent not to be colorable, frivolous or baseless, the conclusion

is inescapable that the referee had no jurisdiction to determine the respective rights of the parties in the balance in the demand loan account.

Nor, moreover, could the jurisdiction of the referee be in any way extended or enlarged by consent of the parties. In certain cases parties may by consent vest jurisdiction in a bankruptcy court which it would not otherwise enjoy, for instance, under Sec. 23-b of the Bankruptcy Act. But it should be noted that this consent goes only to the matter of venue and not to the basic jurisdiction of a bankruptcy court or of a referee in bankruptcy.

*Sinsheimer* v. *Simonson*, 107 Fed. 898 (C. C. A. 6th, 1901);
*Kaigler* v. *Gibson*, 264 Fed. 240 (D. C. Ga., 1920);
*In re Raphael*, 192 Fed. 874 (C. C. A., 7th, 1911).

In the latter case the Court stated, with respect to jurisdiction obtained by consent, that:

"Even though the consent set out in this section be deemed necessary under the facts of this case, such consent 'means consent to the tribunal in which the controversy is to be carried on and not to the mode of procedure, which is regulated by general principles of law unless other provision is made.' Sinsheimer v. Simonson, 107 Fed. 898, 47 C. C. A. 51." (p. 876).

Likewise other courts have definitely decided that consent cannot enlarge the basic jurisdiction of a bankruptcy court or of a referee beyond the scope prescribed by law. If a referee in bankruptcy does not by general principles of law possess jurisdiction, he cannot be granted such jurisdiction by the consent of the parties.

*In re Ballou*, 215 Fed. 810 (D. C. E. D. Ky., 1914);
*In re Walsh Brothers*, 163 Fed. 352 (D. C. Ia., 1908);
*In re Hollins*, 229 Fed. 349 (C. C. A. 2d, 1916).

See also,
*In re Tarbox*, 185 Fed. 985, 986 (D. C. Mass., 1910).

In *In re Ballou, supra,* a petition was filed to review an order of a referee in bankruptcy directing a corporation and its officers to execute and deliver a certain amount of stock to the trustee in bankruptcy. The order was made in a summary proceeding begun by a petition filed with the referee by the trustee and a rule or show cause order issued thereon and was entered after hearing had on the rule or show cause order. The review was sought on the ground that the referee had exceeded his jurisdiction. The trustee, on his part, contended that the corporation and its officers had consented to the jurisdiction. But the court found that consent was not sufficiently shown and, moreover, that in a case of this nature consent could not vest summary jurisdiction in the referee in bankruptcy. The order of the referee was therefore reversed without prejudice to an independent suit. The opinion of the court states the controlling principles of law in a terse and lucid manner. The opinion reads in part (215 Fed. at pp. 814-815):

"The jurisdiction of such a suit is determined by section 23b of the bankrupt act. Under that section this court has jurisdiction of such a suit with the consent of the corporate petitioner, or if the bankrupt could have brought it herein had not bankruptcy ensued, i. e., if diversity of citizenship existed between him and the corporate petitioner and the amount in controversy was in excess of $3,000. Otherwise it can only be brought in the state court.

But though such a suit can be brought in this court with the consent of the corporate petitioner, it cannot be brought before the referee with such consent. The jurisdiction conferred by that section on the district courts cannot be exercised by the referee. Possibly so far as it applies to suits for the recovery of property under section 60, subdivision (b), and section 67, subdivision (e), and section 70, subdivision (e) it can. If so, it can only be because in those other sections jurisdiction is expressly conferred on the court of bankruptcy of such suits, and the referee can exercise such jurisdiction as a court of bankruptcy can. The word 'courts' in section 23b does not include a court of bank-

ruptcy. In Barden v. First National Bank of Howarden, 178 U. S. 524, 20 Sup. Ct. 1000, 44 L. Ed. 1175, Mr. Justice Gray said:

'But the second clause applies both to the District Courts and to the Circuit Courts of the United States, as well as to the state courts. This appears, not only by the clear words of the title of the section, but also by the use, in this clause, of the general words, "the courts," as contrasted with the specific words, "the United States Circuit Courts" in the first and in the third clauses.'

In so far as it applied to District Courts before the abolition of Circuit Courts, it did not apply to them sitting in bankruptcy, and hence it had no application to courts of bankruptcy. It follows that the referee has no jurisdiction of such a suit. It will hardly be maintained that a civil action at law to collect an ordinary undisputed debt or a suit in equity to enforce a specific performance of an undisputed contract can be brought and prosecuted before the referee. If, then, the referee had no jurisdiction of the only remedy which the trustee had, to wit, an independent suit, a fortiori he did not have jurisdiction of a remedy which he did not have, to wit a summary proceeding.

As then the referee did not have jurisdiction of the summary proceeding brought and prosecuted before him independently of consent of the corporate petitioner, he could not acquire jurisdiction with its consent. For it is a fundamental principle that parties cannot confer essential jurisdiction on a court of controversy, if it does not otherwise have it. Of course this does not apply where it is expressly provided that such jurisdiction may be conferred by consent, which is done by section 23b. But the jurisdiction which under that section can be conferred by consent is jurisdiction upon this court not sitting in bankruptcy, and not upon the referee."

Similarly in the case of *In re Walsh Bros., supra*, the District Court stated in its opinion (163 Fed. 352):

"Has a referee in bankruptcy jurisdiction to determine such a controversy, even with the consent of both par-

ties? If the subject matter of a controversy is not within the jurisdiction of a referee, of course, consent will not confer it, and the court upon a petition for review will acquire none except to determine the jurisdiction of the referee. First Nat. Bank v. Title & Trust Co., 198 U. S. 260, 25 Sup. Ct. 693, 49 L. Ed. 1051." (p. 353).

The principles stated in these decisions just discussed are summarized in *Remington on Bankruptcy*, as follows:

> "But this 'consent' confers jurisdiction only in cases where the suit is a plenary suit, or where it is a summary proceedings and the property involved is within the possession of the bankruptcy court or subject to its control, in which latter case even the referee may have jurisdiction. The referee would seem not to possess jurisdiction except in the latter case." (Vol. 5, Sec. 2198).

We submit, therefore, that there can be no force in the contention of the petitioner that the respondent, by the mere act of filing the original reclamation petition, consented to the jurisdiction of the referee to determine rights in the balance of the demand loan account.

The petitioner in his brief at page 33 also presents to the Court as applicable to the case at bar the principle that a bankruptcy court has jurisdiction to adjudicate adverse claims on property in its possession. Conceding the soundness of this principle, we submit that it is irrelevant to the sole issue before this Court, since the property here claimed by the petitioner is not and has never been in the possession, actual or constructive, of the bankruptcy court.

## IV.

**The referee exceeded his power in ordering the respondent forthwith to pay over to the trustee a certain sum of money.**

Assuming *arguendo* that the referee was justified in denying the respondent's motion to strike paragraph 8 from the answer of the trustee, and that the claim of the petitioner is not for the recovery of an alleged debt but is a claim for property in tangible form in the possession of the respondent, and assuming further that the referee was not in error in finding that the respondent had no adverse interest in such property, we submit that the referee nevertheless exceeded his authority in ordering the respondent to pay over a certain sum of money to the petitioner.

At most, the referee had jurisdiction to consider the counterclaim only as a shield and not as a sword. To the extent that the counterclaim asserted by the trustee exceeds the amount claimed by the respondent in its petition for reclamation, the trustee is required to seek his remedy in a plenary action.

> *In re Continental Producing Co.*, 261 Fed. 627 (D. C. Calif., 1919);
> *In re Peacock*, 178 Fed. 851 (C. C. N. C., 1910);
> *Fitch* v. *Richardson*, 147 Fed. 197 (C. C. A., 1st, 1906).

The rule is well stated in *Remington on Bankruptcy*, Vol. 4, Sec. 1471:

> "Likewise there may be no judgment in the bankruptcy proceeding against the claimant where the estate's offset exceeds the creditors' claim. The trustee must seek his remedy by plenary action.

> And it has been held that the referee may not even adjudicate the offset up to the extent of the creditors' claim, unless the trustee waives the excess; for to do so would render the adjudication res judicata in a subsequent plenary suit to recover the excess; but that the proper practice is for the referee simply to stay the payment of the dividend to the claimant, until the trustee can have his counterclaim adjudicated in plenary action."

If the power of a referee in bankruptcy is restricted in the case of a claim by a creditor for a debt owed by the bankrupt estate, *a fortiori* the same restriction should be applied in the case of a petition for reclamation of specific personal property. The absence of adjudicated cases dealing with a reclamation proceeding does not justify the application of a different principle. In fact a claim by a creditor for a debt owed by the bankrupt estate and a petition to reclaim specific property at the time in the possession of the bankrupt estate are similar, inasmuch as both diminish the estate ultimately distributable to general creditors. The creditor who files a simple proof of claim can be said to have submtted himself to the jurisdiction of the referee to at least as great an extent as the creditor who files a reclamation petition for the recovery of specific property. If the referee cannot enter an affirmative judgment on a counterclaim against the former (and the cases clearly so hold), *a fortiori* he cannot do so against the latter.

The petitioner in his brief at page 74 attempts to escape this rule of law by arguing that the order of the referee is not a money judgment but merely a turnover order, which cannot be enforced by execution but only by commitment for contempt. Yet it remains that the order of the referee inherently carries the determination of the respective rights of the parties in the demand loan account. Such determination is presumably *res judicata*. In fact, it is so claimed by the petitioner in his brief at page 64. Moreover, the decisions uniformly hold such a principle.

*In re J. H. Small Shoe Co.*, 5 F. (2d) 956 (C. C. A. 2nd, 1925). (See cases cited therein at p. 957.)
*In re John Osborn's Sons & Co., Inc.*, 177 Fed. 184, 186 (C. C. A. 2d, 1910).

Although the petitioner in his brief at page 74 seeks to distinguish the effect of the turnover order of the referee from a money judgment, he asserts at page 65 that the petitioner could execute on the turnover order, as on an ordinary money judgment, by garnishment or equitable sequestration of debts owed to the respondent by persons resident in Nebraska. The fundamental lack of jurisdiction of the referee is not cured by issuing a turnover order. We presume that the petitioner is not seeking to uphold the validity of this turnover order if it subsequently serves no effective legal purpose.

In short, the question is not altered in any way by the issuance of a turnover order rather than a money judgment. As we have endeavored to show in the earlier portion of this brief, the referee lacked jurisdiction to determine the facts which formed the basis of the order; and even if he had jurisdiction to determine the facts, he had no jurisdiction to enter an order for affirmative relief.

## CONCLUSION.

In concluding, it may not be amiss to consider briefly the relative positions of the parties to this litigation, and the results which would follow if petitioner's argument should be sustained. Petitioner admits that the bonds originally shipped to the bankrupt remain unpaid for, and that there is (or was) a valid claim for the purchase price. We readily admit that if respondent had pressed its reclamation claim to a successful conclusion and had recovered possession of the specific bonds, it could not then have claimed the purchase price as well. A reclamation order giving respondent the bonds would of necessity have required, and

could properly have been conditioned upon, the cancellation of the debit charge for their value, and the restitution to the bankrupt estate of the amount of that charge out of the collateral in the demand loan account.

It would be contrary to natural justice to permit either party to the transaction to enrich itself by retaining both the bonds and the purchase price. But what is the present situation? Petitioner has established his title to the bonds and retains them in the bankrupt estate. In this proceeding he seeks to deny to the respondent not only the right to reclaim the bonds specifically, but also the right to retain or set off the purchase price. Upon petitioner's contention, respondent's remedy was to surrender both the bonds and the purchase price (i. e., the amount of the debit charge made on November 27th, 1929), and to file proof of claim for the purchase price,—a remedy which petitioner gives us to understand is nugatory, since the six months for filing proof of claim has expired.

If petitioner's claim be sustained, and the referee's order affirmed, then of necessity the bankrupt estate will be enriched by retaining both the bonds and the purchase price, unless respondent can establish that the period for filing proof of claim is extended, under Section 57n, by the existence of this litigation.

Rightly or wrongly, respondent filed no proof of claim, since it believed its remedy to be by reclamation or set off. We believe, and the Circuit Court of Appeals has held, that the referee had no jurisdiction to pass upon the validity of that set off, and that petitioner, if he disputes its validity, should be left to his remedy in a hearing on the merits in a plenary suit. If this be correct, and we submit that it is, the decision of the Circuit Court of Appeals should be affirmed. If on the other hand that Court was in error, and the referee had jurisdiction to adjudicate the trustee's claim, we respectfully suggest that this Court should re-

mand the case without prejudice to a full consideration by the referee or the District Court of the equities between the parties.

**It is therefore respectfully submitted that the judgment of the Circuit Court of Appeals was correct and should be affirmed.**

December 3, 1931.

Respectfully submitted,

JOHN W. DAVIS,
THOMAS GARRETT, JR.,
PORTER R. CHANDLER,
CHARLES POLETTI,
Counsel for Respondent.

# APPENDIX.

## Summary of Demand Loan Account of Peter Trust Company (See R. 18-19 and 41-42.)

| | | |
|---|---|---|
| November 25, 1929. | Balance due ..... | $156,700.00 |
| | Deposit applied (credit) | 31,046.53 |
| | Proceeds of mortgages (credit) ..... | 2,500.00 |
| | Net balance due..... | 123,153.47 |
| " 27, 1929. | *Assigned account for purchase of bonds (debit)* | *23,055.82* |
| | Balance due Nov. 27, 1929 | 146,209.29 |
| December 2, 1929. | Proceeds of mortgages (credit) ..... | 72,592.36 |
| | Balance due Dec. 2, 1929 | 73,616.93 |
| January 17, 1930. | Proceeds of mortgages (credit) ..... | 21,213.71 |
| | Balance due Jan. 17, 1930 | 52,403.22 |
| " 23, 1930. | Proceeds of mortgages (credit) ..... | 6,068.75 |
| | Balance due Jan. 23, 1930 | 46,334.47 |
| February 3, 1930. | Proceeds of mortgages (credit) ..... | 10,404.45 |
| | Balance due Feb. 3, 1930 | 35,930.02 |
| " 11, 1930. | Proceeds of mortgages (credit) ..... | 11,072.05 |
| | Balance due Feb. 11, 1930 | 24,857.97 |
| " 13, 1930. | Proceeds of mortgages (credit) ..... | 6,646.25 |
| | Balance due Feb. 13, 1930 | 18,211.72 |
| March 3, 1930. | Proceeds of mortgages (credit) ..... | 19,354.13 |

*(Continued on Next Page.)*

| | | | | |
|---|---|---|---|---|
| | | Balance due Peters March 3, 1930 ..... | | 1,142.41 |
| " | 4, 1930. | Proceeds of mortgages (credit) ..... | | 3,588.34 |
| | | Balance due Peters March 4, 1930 ..... | | 4,730.75 |
| " | 14, 1930. | Proceeds of mortgages (credit) ..... | | 5,009.93 |
| | | Balance due Peters March 14, 1930 ..... | | 9,740.68 |
| | | Interest owing by Peters (debit): | | |
| | | On demand loan a/c .. | $1,571.90 | |
| | | On assigned a/c ..... | 385.22 | |
| | | | | 1,957.12 |
| | | Balance due Peters..... | | 7,783.56 |
| April | 14, 1930. | Draft of trustee paid (R. 12) ..... | | 7,500.00 |
| | | Balance due Peters..... | | $ 283.56 |

NOTE: The amount claimed by the trustee from the Guaranty Trust Company and awarded by the referee's order (R. 22) is $23,724.60. The amount originally debited as an off-set by the Guaranty Trust Company, on account of the bonds sold, is only $23,055.82. The discrepancy between these two figures is thus explained:

| | |
|---|---|
| Amount debited by Guaranty..... | $23,055.82 |
| Add accrued interest..... | 382.22 |
| Add balance admitted to be due to the trustee ..... | 283.56 |
| | $23,724.60 |

The item of $283.56 above mentioned was admitted to be due to the trustee, and was in fact paid to him after the decision of the Circuit Court of Appeals.